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Supreme Court of the United States

October Term 1943

No. 183

B. H. INNESS BROWN, DAVID PAINE, ETHELBERT WARFIELD, J. FEARON BROWN, GEORGE KOEGLER, and MURRAY MACELHINNY, individually and as co-partners under the firm name of Kellogg, Emery & Inness-Brown,

and

LAWRENCE S. GREENBAUM, EDWARD S. GREENBAUM, HERBERT A. WOLFF, MORRIS L. ERNST, JONAS J. SHAPIRO, WALLACE D. JENNINGS, SAMUEL J. SCHUR and ALEXANDER LINDEY, individually and as co-partners under the firm name of Greenbaum, Wolff & Ernst,

Petitioners,

against

JOHN GERDES and JAMES D. CARPENTER, JR., Trustees of Reynolds Investing Co., Inc., Debtor,

Respondents.

BRIEF IN SUPPORT OF PETITION

DAVID PAINE,
LAWRENCE GREENBAUM,
Counsel for Petitioners.

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Respondents.

BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinions of the Supreme Court are not officially reported, but appear at R. 98-113. The Appellate Division wrote no opinion; the opinion of the Court of Appeals and dissent therefrom are reported in 290 N. Y. 468 and appear at R. 124-9.

Jurisdiction

A statement as to jurisdiction appears in the petition, pages 5-6.

Statement of the Case

A summary statement of the facts is given in the petition, pages 2-5.

Statutes Involved

The constitutional provision and the statutes involved are set forth in an Appendix attached to the petition, except that Section 475 of the Judiciary Law of the State of New York is set forth in the petition, pages 5-6.

POINT I

The Court of Appeals has decided an important Federal question of substance not heretofore determined by this Court and in conflict with the decisions of the Circuit Court of Appeals for the Second and Eighth Circuits, in holding that the Bankruptcy Court had exclusive jurisdiction under the Constitution and the Bankruptcy Act, which precluded the State Court from fixing the liens of the Attorneys upon causes of action prosecuted in the State Court on behalf of the Debtor and the Trustees with the authority of the Bankruptcy Court.

Chief Judge Lehman and Judges Loughran and Conway dissented on the ground that the decision was in conflict with the ruling of the Circuit Court of Appeals for the Second Circuit in *Sherman* v. *Buckley*, 119 F. (2d) 280, cert. den. 314 U. S. 657.

An examination of the opinion, record and petition for certiorari in the *Sherman* case shows that the Court passed upon the very issue involved here and decided exactly contrary to the Court of Appeals.

The facts in the *Buckley* case follow:

Gould, by Buckley & Buckley, his attorneys, sued in the New York Supreme Court. The complaint was dismissed. In January, 1934, while an appeal was pending, Gould was adjudicated a bankrupt and Sherman was appointed trustee. The trustee then procured authorization of the Bankruptcy Court to proceed with the New York action in the name of Gould the bankrupt, the avails thereof, however, to inure to the bankrupt's estate. In 1935 the trustee determined to substitute other attorneys in place of the Buckley firm. Thereafter, upon motion by the trustee in the State Court, an order was entered substituting other attorneys for the

Buckley firm and fixing the latter's lien for services at 30% of any recovery obtained in the action. Subsequently, the case was settled for $40,000. The Buckley firm thereupon applied to the State Court for an order directing the defendants to pay them the amount of their lien. The trustee then applied to the Bankruptcy Court to enjoin the Buckley firm from enforcing their lien. He contended that the New York Court was "without jurisdiction to adjudicate the value of their lien"; that "the avails of the action belong to the Trustee in Bankruptcy and are within the custody of the United States District Court," and that the proceeding sought to be enjoined "constitutes an interference with the jurisdiction of that Court in its paramount right to administer the bankrupt estate" (Rec. on App., ff. 19-24, 31).

The District Court granted the injunction.

The Circuit Court of Appeals reversed and held that the District Court had no power to interfere with the Buckleys' lien or with their right to have it determined and enforced in the State Court. Rejecting the argument of the Trustee that the fixing of the lien constituted an interference with the exclusive bankruptcy jurisdiction of the Bankruptcy Court, the opinion (per L. Hand, J.) stated (p. 282):

> "• • • He [the trustee] could of course substitute other attorneys, as he did, and Buckley & Buckley were obliged to retire; but the substitution did not affect their charging lien under §475 of the Judiciary Law of New York, Consol. Laws, c. 30, or their possessory lien upon the papers.
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> • • • • • • •
>
> "In spite of the fact that the jurisdiction of the bankruptcy court is usually described as 'exclusive,' it may consent to have the interests of third persons in property of which the bankrupt had possession, adjudicated in a state court if that is more convenient. *Foust* v. *Munson S. S. Lines*, 299 U. S. 77, 57 S. Ct. 90, 81 L. Ed. 49; *Texas* v. *Donoghue*, 302 U. S. 284,

58 S. Ct. 192, 82 L. Ed. 264; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483, 60 S. Ct. 628, 84 L. Ed. 876; *In re Schulte-United, Inc.*, 2 Cir., 49 F. (2d) 264. As we have said, the trustee got the permission of the bankruptcy court to allow the action to be prosecuted in the state court. That necessarily involved a consent to such incidents as the exercise of that court's jurisdiction might involve, among them that, as a condition upon the substitution of new attorneys, the charging lien of the displaced attorneys must be liquidated."

Certiorari was denied (314 U. S. 657).

That the decision of the Circuit Court of Appeals in the *Sherman* case involved the identical issues presented here is plain from the petition for certiorari by the trustee in the *Sherman* case. There (Petition, pp. 30-31) the Trustees listed the questions involved as follows:

"The issues in the instant case raise several questions which are of the utmost importance, so that bankruptcy courts and their officers may know just what acts of theirs would constitute a consent that some other court determine questions which otherwise would rest solely in the jurisdiction of the bankruptcy court.

"These questions are as follows:

"1. Where a bankruptcy court consents that a trustee prosecute an action *in personam* in the name of a bankrupt, does such consent carry with it the implied consent that the court in which such action is pending may determine claims to or liens against the proceeds of such action?

"2. Where a trustee institutes, intervenes in, or continues in the name of a bankrupt, a plenary suit *in personam* for money damages, does the trustee thereby submit himself to the jurisdiction of the court in which such suit is instituted or is pending to the extent that such court may determine liens or claims, such as attorneys' liens, against the proceeds of such suit?

"3. Where a trustee, with the consent of the bankruptcy court, allows to be continued in the name of

> a bankrupt a plenary suit *in personam*, with the understanding that the fruits of such suit shall inure to the benefit of the bankrupt's estate, does he thereby submit himself to the jurisdiction of the court in which such suit is pending so that he is liable for costs, or attorneys' fees, etc.?"

The doctrine enunciated in *Sherman* v. *Buckley* was applied by the Circuit Court of Appeals (Second Circuit) in *New York Creditmen's Ass'n* v. *Schlesinger*, 126 F. (2d) 472. The Circuit Court of Appeals, Eighth Circuit, in *Ohio Oil Co.* v. *Thompson*, 120 F. (2d) 831, 836-837, cert. den. 314 U. S. 658, following the *Sherman* decision, has announced the same doctrine. Said Thomas, C. J., at pages 836-837:

> "• • • It has often been affirmed in cases of bankruptcy that, although the courts of the United States have exclusive jurisdiction 'of all matters and proceedings in bankruptcy', or, as stated in the opinion of the Supreme Court in this case, 'an exclusive and nondelegable control over the administration of an estate in its possession', when a trustee, having been given authority to do so, appears in a state court to litigate his right to property the state court has jurisdiction of all the incidents of the litigation, and its judgment in such action is binding upon him. (Citing Sherman v. Buckley and other cases.)"

These decisions are but an application of the rule that a trustee appointed under the Bankruptcy Act who becomes an active litigant in a State Court occupies the same status as any other litigant and is subject to such terms and conditions as the laws of the State impose upon the other litigants. *Boteler* v. *Ingels*, 308 U. S. 57; *In re Neely*, 113 Fed. 210 (C. C. A. 2); *Fischer* v. *Pauline Oil & Gas Co.*, 309 U. S. 294; *Ark. Corp. Commission* v. *Thompson*, 313 U. S. 132.

By Judiciary Law § 475, quoted above, the State of New York, to protect its attorneys, has imposed a condition upon persons seeking access to its courts, namely, that an

attorney under appropriate circumstances may have the New York Court determine and enforce his lien. The underlying principle of *Sherman* v. *Buckley* is that a trustee under the Bankruptcy Act is subject to this condition of local law just as he would be subject to other local laws or rules pertaining to litigation such as costs, execution, supplementary proceedings, etc. This principle was followed in *In re Prudence Co.*, 96 F. (2d) 157 (C. C. A. 2), cert. den. 305 U. S. 616, in which the Court, discussing the lien rights of a New York attorney who successfully prosecuted an action for the benefit of an estate in reorganization under Section 77B, stated (p. 160):

> "Success having been achieved, they [the trustees] can reap the benefit of the judgment, but they take it subject to the attorney's charging lien."

The decision of the Court of Appeals in the instant case works a complete nullification of lien laws so far as debtors and their trustees are concerned and clothes them with immunity from the operation of State laws not possessed by other litigants—a result inconsistent with that reached by the Circuit Court of Appeals and opposed to the recent statement in *Boteler* v. *Ingels*, 308 U. S. 57, 61, that "clearly, means of permitting such immunity from local laws will not be read into the Bankruptcy Act."

Thus, a sharp conflict exists between the Court of Appeals and the Circuit Courts of Appeal upon an important question of the construction of the reorganization statutes and their effect on the jurisdiction of State Courts. A definitive ruling is necessary to settle this conflict and to remove any doubt in the administration of estates under the reorganization provisions of the Bankruptcy Act and to define the scope and validity of attorneys' liens in actions instituted by debtors or their trustees in State Courts.

It is respectfully submitted that the present appeal furnishes an appropriate occasion for the granting of certiorari. See *Emil* v. *Hanley*, 130 F. (2d) 369, cert. granted

317 U. S. 621, aff'd U. S. , 87 L. Ed. 643; *Fidelity Assurance Corp.* v. *Sims*, 129 F. (2d) 442, cert. granted 317 U. S. 614, aff'd U. S. , 87 L. Ed. 725; *Gross* v. *Irving Trust Co.*, 61 F. (2d) 812, cert. granted 288 U. S. 598, aff'd 289 U. S. 342; *Palmer Clay Products Co.* v. *Brown*, 297 U. S. 227-228.

POINT II

The Court of Appeals in determining that the Federal Court did not surrender its jurisdiction to fix petitioners' fees has determined a Federal question in a way probably in conflict with decisions of this Court.

As noted, the plenary suits in the State Court were instituted under specific order of the Reorganization Court and were prosecuted therein with its approval.

In holding that this action of the Reorganization Court did not constitute a surrender of its jurisdiction and a submission of the debtor and its trustees to the State Court, the Court of Appeals decided the case in a way not only flatly at variance with *Sherman* v. *Buckley*, 119 F. (2d) 280 (C. C. A. 2nd), cert. den. 314 U. S. 657, and *New York Credit Men's Assn.* v. *Schlesinger*, 126 F. (2d) 472 (C. C. A. 2nd), but also probably in conflict with the decisions in this Court to the effect that when a Federal Court permits or authorizes its trustee to litigate claims in a State Court, it surrenders its jurisdiction over such claims and their incidents, and the trustee submits himself to and is bound by the laws of the State, statute or otherwise.

Foust v. *Munson S. S. Lines*, 299 U. S. 77;
State of Texas v. *Donoghue*, 302 U. S. 284;
Thompson v. *Magnolia Petroleum Co.*, 309 U. S. 478;
United States v. *Shaw*, 309 U. S. 495.

POINT III

In holding that a cause of action in favor of a debtor, which must be enforced in a State Court, is an asset within the jurisdiction of the reorganization court, the Court of Appeals has decided a Federal question of substance in conflict with decisions of Circuit Courts of Appeal, and, probably, in conflict with the decisions of this Court.

In the preceding argument, based upon *Sherman* v. *Buckley, supra,* it was assumed that the Bankruptcy Court initially had jurisdiction of the causes of action in favor of the debtor, and that by authorizing the institution of suit in the State Court it thereby surrendered its jurisdiction to that Court over the causes of action and the incidents thereof, including the attorneys' liens under local law.

The Court of Appeals is at odds with Circuit Courts of Appeals in holding that under the Bankruptcy Act in effect at the time the principal State suit was brought, the Bankruptcy Court had jurisdiction of the cause of action. The Federal rule is that jurisdiction at all times over such cause of action was in the State Court where suit had to be brought, so that it was only that part of the assets recovered in the State suit, less the amount of the attorneys' charging lien and other costs fixed by the State Court, that ever became subject to administration in bankruptcy.

Respondents urged below, and the Court of Appeals held, that under Chapter X of the Bankruptcy Act the jurisdiction of the Reorganization Court has been extended to embrace causes of action in favor of a debtor. Chapter X did not become effective until September 22, 1938. The petition for reorganization herein was filed May 18, 1938, and the principal New York action was brought on August 4, 1938.

In holding that Chapter X obtains, not Chapter VIII (Sec. 77B), the Court of Appeals is at variance with the Circuit Courts of Appeals, Second and Third Circuits.

Thus, in *In re Standard Gas & Elec. Co.*, 119 F. (2d) 658-663, where a company, in reorganization under Chapter VIII (Sec. 77B), commenced an action in the Federal Court against former officers in June, 1938, prior to the effective date of Chapter X, the Third Circuit held that the jurisdiction of the reorganization court was fixed by Section 77B. Maris, C. J., wrote:

> "The provisions of Chapter X are made applicable to reorganization proceedings but are not extended to plenary actions involving controversies at law or in equity, instituted before the effective date of that chapter."

Similarly, the Circuit Court of Appeals, Second Circuit, held in *Tilton* v. *Model Taxi Corp.*, 112 F. (2d) 86, 88 (per Patterson, C. J.):

> "In the Chandler Act (11 U. S. C. A., § 502) it is provided that section 23 of the Bankruptcy Act shall not be applicable to proceedings under Chapter X, and it may be that the District Court would have jurisdiction of an action of the present sort brought by a trustee appointed under that chapter, even where the defendant did not consent. The Chandler Act did not take effect until after joinder of issue in the present action, and we see no occasion to discuss whether the jurisdiction of the court has been broadened by the later legislation."

Indeed it would appear that an interpretation of Chapter X which would give it retroactive operation so as to impair or destroy the attorney's liens which had previously accrued under local law would render the statute as applied unconstitutional in depriving the attorney of property without due process of law.

Under the decisions of Circuit Courts of Appeals and of this Court, such jurisdiction under Section 77B did not

include causes of action in favor of a debtor in reorganization. *In re Prima Co.*, 98 F. (2d) 952, 957 (C. C. A. 7th), cert. den. *Keig* v. *Harris Trust & Savings Bank*, 305 U. S. 658; *In re Standard Gas & Elec. Co.*, 119 F. (2d) 658, 661-662 (C. C. A. 3d); *Tilton* v. *Model Taxi Corp.*, 112 F. (2d) 86 (C. C. A. 2d); *Taubel-Scott-Kitzmiller Co., Inc.* v. *Fox*, 264 U. S. 426.

The principal basis of these decisions rests upon the provisions of Section 23 of the Bankruptcy Act, which is in terms applicable to proceedings under Section 77B, but which is expressly inapplicable to proceedings under Chapter X.

In *Schumacher* v. *Beeler*, 293 U. S. 367, 374, this Court, examining the legislative history of Section 23, stated:

> "In enacting §23, it was clearly the intent of the Congress that the federal courts should not have the unrestricted jurisdiction of suits between trustees in bankruptcy and adverse claimants which these courts had exercised under the broad provisions of §2 of the Act of 1867."

Attention is particularly directed to the Court's opinion in *In re Standard Gas & Elec. Co., supra*, where Maris, J., said at pp. 661-2:

> "In a broad sense a claim by a debtor against a third person is property of the debtor. As such the reorganization court may direct its prosecution by the trustee of the debtor if it is appropriate to do so in order to effect the debtor's reorganization. But it is a species of property which may only be realized upon for the benefit of the debtor and its creditors by the successful prosecution of a plenary suit against the third persons involved. We have seen that section 77B does not purport to confer jurisdiction over those persons. Such claims must therefore be enforced by plenary suits brought in courts whose existing jurisdiction is appropriate to entertain them."

See also:

In re Prima Co., supra, per Spark, C. J., p. 957.

Not only did the Reorganization Court lack any jurisdiction to entertain causes of action in favor of the debtor, but, in addition, the State Court, in which the respondent Trustees were compelled to sue, had control of every phase and incident of the suit. Thus, it had power to cause the examination of third persons, determine whether the claim should be tried by court or jury, determine the amount owed the debtor by the third persons, approve settlement of the action, impose costs, issue execution and invoke proceedings supplementary to execution. Since such exclusive jurisdiction resides in the State Court with respect to causes of action owned by a debtor in reorganization, it seems strange to claim that the Reorganization Court had jurisdiction thereof. The New York Supreme Court (R. 107) logically said:

> "It is, indeed, a little short of an absolute contradiction to say that a bankruptcy court has possession of something which the trustee must go into another court in order to get."

On proper consideration of the Bankruptcy Act it would seem to follow conclusively that it is only that part of the cause of action which remained after the deduction of the attorneys' lien, and other costs and allowances imposed by the State Court, that ever became subject to administration in bankruptcy. This is in exact accord with the decision in *In re Prudence Co.*, 96 F. (2d) 157 (C. C. A. 2d), cert. den. 305 U. S. 616, discussed *supra*, p. 6.

Thus, with respect to the principal New York suit it is plain on two grounds, under the decisions referred to, that the lien upheld by the New York Court did not invade the exclusive jurisdiction of the Bankruptcy Court: First, this cause of action did not fall within the jurisdiction of the Bankruptcy Court; second, if it did, that Court surrendered

its jurisdiction to the State Court by directing the institution of suit there.

The other two actions were commenced after the effective date of Chapter X. They were, however, prosecuted by the Trustees in the State Court under specific order of the Bankruptcy Court. The liens allowed by Justice Walter in the Supreme Court covered these cases, as well as the main case. Assuming that Chapter X gave the Reorganization Court jurisdiction of those causes of action, that jurisdiction was surrendered to the State Court for the actions themselves and the incidents resulting. *Thompson* v. *Magnolia Company, Sherman* v. *Buckley, supra.*

In the present uncertain state of the law resulting from this decision of the Court of Appeals an extraordinary situation exists whereby, presumably, the State Court can exercise every control over the State Court litigations and its remedies and incidents, except the one right to fix the liens of attorneys therein under explicit local statute, and jurisdiction for that purpose would thus vest exclusively in the Reorganization Court. Of course, such divided control can lead only to confusion and was never heretofore contemplated by any court. It appears to be opposed to all other decisions on the question. The question is of importance and should be resolved by this Court.

Respectfully submitted,

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Dated, July 19, 1943.